

Sturgis Hospital

Financial Report
September 30, 2008

Sturgis Hospital

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Independent Auditor's Report

To the Board of Directors
Sturgis Hospital

We have audited each Enterprise Fund and the business-type activities of Sturgis Hospital (the "Hospital"), a component unit of the City of Sturgis, Michigan, as of and for the years ended September 30, 2008 and 2007 as listed in the table of contents, which comprise the accompanying basic financial statements. These basic financial statements are the responsibility of the Hospital's management. Our responsibility is to express opinions on these basic financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and each major fund of Sturgis Hospital as of September 30, 2008 and 2007 and the changes in financial position and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis, as identified in the table of contents, is not a required part of the basic financial statements but is supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

Plante & Moran, PLLC

December 17, 2008

Sturgis Hospital

Management's Discussion and Analysis

Our discussion and analysis of Sturgis Hospital (the "Hospital") financial performance provides an overview of the Hospital's financial activities for the fiscal years ended September 30, 2008 and 2007. Please read it in conjunction with the Hospital's financial statements, which begin on page 8.

Financial Highlights

- The Hospital's net assets decreased \$124,965 in 2006, \$99,888 in 2007 and then decreased \$397,994 in 2008.
- The Hospital reported operating losses in 2006 (\$327,119), 2007 (\$1,724,849), and 2008 (\$303,299). The operating results for 2008 improved by \$1,421,550 or 82.4 percent over the operating results reported in 2007. Operating results in 2007 decreased by \$1,397,730, or 427 percent over the operating results reported in 2006.
- Nonoperating revenue decreased in 2008 by \$1,719,656, compared to 2007. Nonoperating revenue increased in 2007 by \$1,173,077, or 260 percent, compared to 2006.

Using this Annual Report

The financial statements consist of three statements: (a) a balance sheet, (b) a statement of revenues, expenses, and changes in net assets, and (c) a statement of cash flows. These financial statements and related notes provide information about the activities of the following:

- Sturgis Hospital, a component unit of the City of Sturgis, Michigan
- Grobhiser medical office building, a blended component unit of the Sturgis Hospital
- Sturgis Hospital Foundation is a blended component unit of Sturgis Hospital

The collection of financial activities identified above is referred to as the "Hospital."

The Balance Sheet and Statement of Statement of Revenue, Expenses, and Changes in Net Assets

One of the most important questions asked about the Hospital's finances is, "Is the Hospital as a whole better off or worse off as a result of the year's activities?" The balance sheet and statements of revenue, expenses, and changes in net assets report information on the Hospital as a whole and on its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. All the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

Sturgis Hospital

Management's Discussion and Analysis (Continued)

These two statements report the Hospital's net assets and changes in them. You can think of the Hospital's net assets - the difference between assets and liabilities - as one way to measure the Hospital's financial health or financial position. Over time, increases or decreases in the Hospital's net assets are one indicator of whether its financial health is improving or deteriorating. You will need to consider other nonfinancial factors, however, such as changes in the Hospital's patient base and measure of the quality of service it provides to the community, as well as local economic factors, to assess the overall health of the Hospital.

The Statement of Cash Flows

The final required statement is the statement of cash flows. This statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. It provides answers to such questions as, "Where did cash come from?" "What was cash used for?" and "What was the change in cash balance during the reporting period?"

The Net Assets

The following is a comparative analysis of the major components of the statement of net assets of the Hospital:

	September 30		
	2006	2007	2008
Assets			
Current assets	\$ 9,939,410	\$ 13,089,043	\$ 13,271,426
Noncurrent assets	3,919,411	881,102	816,189
Capital assets	21,087,833	20,630,674	20,192,664
Total assets	<u>\$ 34,946,654</u>	<u>\$ 34,600,819</u>	<u>\$ 34,280,279</u>
Liabilities			
Current liabilities	\$ 5,592,916	\$ 5,901,763	\$ 5,767,532
Long-term liabilities	12,244,430	11,689,636	11,901,321
Total liabilities	<u>\$ 17,837,346</u>	<u>\$ 17,591,399</u>	<u>\$ 17,668,853</u>
Net Assets			
Invested in capital assets - Net of related debt	\$ 8,424,925	\$ 8,536,277	\$ 7,747,681
Unrestricted	8,143,778	8,465,796	8,855,908
Restricted for specific purpose	540,605	7,347	7,837
Total net assets	<u>\$ 17,109,308</u>	<u>\$ 17,009,420</u>	<u>\$ 16,611,426</u>

The Hospital's net assets increase in 2006 by minor amounts, but decreased in 2007 and 2008 by minor amounts. However, fluctuations between current and noncurrent assets between 2007 and 2006 were significant. A shifting from long-term investments to short-term investments relates to the maturity cycle of the portfolio held during 2007.

Sturgis Hospital

Management's Discussion and Analysis (Continued)

Operating Results for the Year

	2006	2007	2008
Operating Revenue			
Net patient service revenue	\$ 36,609,444	\$ 37,236,828	\$ 37,492,014
Other operating revenue	402,867	364,796	320,797
Total operating revenue	37,012,311	37,601,624	37,812,811
Operating Expenses			
Salaries and wages	14,971,330	15,815,092	15,499,778
Benefits	6,404,404	6,272,806	5,378,461
Fees	4,892,232	5,253,686	5,345,952
Supplies	5,532,760	5,583,448	5,215,624
Purchased services	963,674	1,110,562	1,205,192
Other expense	1,790,420	2,031,878	2,264,261
Utilities	806,408	921,594	917,349
Insurance	698,004	769,811	748,168
Depreciation/Amortization	1,280,198	1,567,596	1,541,325
Total operating expenses	37,339,430	39,326,473	38,116,110
Operating Loss	(327,119)	(1,724,849)	(303,299)
Nonoperating Revenue (Expense) - Net	451,884	1,624,961	(94,695)
Increase (Decrease) in Net Assets	<u>\$ 124,765</u>	<u>\$ (99,888)</u>	<u>\$ (397,994)</u>

Operating Losses

The first component of the overall change in the Hospital's net assets is its operating income (loss), generally the difference between net patient service revenue and the expenses incurred to perform those services. Net patient revenue includes patient service revenue less deductions from revenue. Deductions from revenue includes amounts written off related to contractual discounts given to third parties, charity care provided to indigent patients, and bad debts expenses related to uncollectible patient balances. In each of the past years, the Hospital has reported an operating loss. In 2008, the Hospital reported improvement by reducing the operating loss by \$1,421,550. This was primarily the result of the following factors:

- Decreases in operating expenses of \$1,210,363; 3.0 percent in 2008
- Decreases in salaries and wages of \$315,314; 2.0 percent in 2008
- Decreases in supply expenses of \$367,824; or 6.6 percent in 2008

Sturgis Hospital

Management's Discussion and Analysis (Continued)

Declines in patient volumes in 2008 were compounded with a shift in our patient mix and a shift in our patient service lines. The increase in the volume of patient revenue represented by Medicare, Medicaid, and Blue Cross (fixed payers) contributed to higher contractual discounts in 2008. Medicare is a program for the elderly and Medicaid is a program for the indigent and Blue Cross is a carrier with significant market influence. The discounts required by the fixed payers are much higher than discounts provided to commercial patients. In addition, the discount rate for the fixed payers increased as a result of a shift from lower discount surgical services to higher discount medical services. This trend was much more significant in 2007 than in 2008. However, the downturn of our local economy during 2008 contributed to higher charity care amounts and bad debt write-offs and discounts related to increases in the number of Medicaid patients.

Staffing reductions, decreases in insurance (malpractice and property), and reductions in fees for physical therapy and anesthesiology contributed to the \$1,210,363 decrease in operating expenses in 2008. The physical therapy volume and anesthesiology expenses decreased as a result of our shift in patient services from surgical to medical during 2008.

The 2008 decreases in salaries and wages of \$315,314 relates principally to the consolidation and closure of rural health clinics related to decreases in volumes of outpatient services.

Other changes in operating expenses were modest with 1.8 percent increases in fees and increases of 8.5 percent in purchased services and a .5 percent decrease in utilities cost as the result of clinic closures.

Nonoperating Revenue - Net

The decrease in the nonoperating revenue of \$1,719,656 resulted from a transaction in 2007, the sale of 10 bed licenses to another healthcare organization. This bed sale renders the count of the licensed beds to 84 for Sturgis Hospital. The average daily census during any of the past 10 years has not exceeded 50. The average daily census for 2007 and 2008 was 17.8; no significant change noted between the two years. However outpatient volumes (registrations) decreased by 5,168 or 6.2 percent. The bed sale did not however jeopardize future growth plans for the Hospital.

Sturgis Hospital

Management's Discussion and Analysis (Continued)

Statement of Cash Flows

Another way to assess the financial health of a Hospital is to look at the statement of cash flows. Its primary purpose is to provide relevant information about the cash receipts and cash payments of an entity during a period. The statement of cash flows also helps assess the following:

- An entity's ability to generate future net cash flows
- Its ability to meet its obligations as they come due
- Its needs for external financing

	2006	2007	2008
Cash provided by (used in):			
Operating activities	\$ (1,697,370)	\$ 447,640	\$ 1,398,766
Capital and related financing activities	(9,132,446)	(227,557)	(867,626)
Investing activities	8,418,450	1,516,819	130,614
Net increase (decrease) in cash	(2,411,366)	1,736,902	661,754
Cash - Beginning of year	4,817,733	2,406,367	4,143,269
Cash - End of year	<u>\$ 2,406,367</u>	<u>\$ 4,143,269</u>	<u>\$ 4,805,023</u>

As indicated in the table above, the increase of cash for operating activities during 2008 relates principally to a build of the patient accounts receivable and a decrease in the payable to third parties for cost report settlements. Conversely, the cash provided by operating activities during 2007 related to an increase in the payable to third parties for cost report settlements. These fluctuations between years are difficult to predict and can be a matter of timing of audits related to the cost reports.

The use of cash for capital and related financing relates to the completion of the expansion project in the prior year and current capital equipment purchases. The liquidation of investments during 2006 occurred to pay for the expansion during 2006. The increase in cash from investing activities during 2007 related to a shift from a longer lived investment portfolio to a shorter position. This shift is a matter of timing of maturities related to invested assets.

Sturgis Hospital

Management's Discussion and Analysis (Continued)

Capital Asset and Debt Administration

Capital Assets

At September 30, 2008, the Hospital had approximately \$43.6 million invested in capital assets, and accumulated depreciation of \$23.4 million. Depreciation and amortization totaled approximately \$1.5 million for the 2008 compared to \$1.6 million for 2007. Construction in progress relates to the Medical Commons Physician Office Building project which commenced in March 2008. Details of these assets for the past three years are shown below:

	2006	2007	2008
Land and improvements	\$ 492,850	\$ 495,850	\$ 495,850
Buildings and improvements	24,050,192	24,808,230	24,871,542
Furniture, fixtures, and equipment	16,886,183	17,159,269	17,324,688
Construction in progress	-	61,657	930,174
Total	<u>\$ 41,429,225</u>	<u>\$ 42,525,006</u>	<u>\$ 43,622,254</u>

Debt

At year end 2008, the Hospital had \$12.4 million of loans and notes as compared to \$12.1 million the previous year.

The Hospital paid down approximately \$407,000 during 2008, in alignment with its prescribed debt schedules. More detailed information about the Hospital's long-term liabilities is presented in the notes to the financial statements.

Economic Factors

The economic position of the Hospital is closely tied to that of the local economy. Because of limited economic growth and increased demand for resources where reimbursement is limited by federal and state mandates, the Hospital continues to look at cost containment measures. However, there have been many investments made during both 2008 and 2007 in the physical plant and the medical staff which management believes will position the Hospital well for the future.

Contacting the Hospital's Financial Management

The financial report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Hospital's chief financial officer, Sterling W. Bill Johnson, 916 Myrtle Avenue, Sturgis, Michigan 49091.

Sturgis Hospital

Balance Sheet September 30, 2008

	Sturgis Hospital	Grobheiser	Sturgis Hospital Foundation	Eliminating Entries	Total
Assets					
Current Assets					
Cash and cash equivalents	\$ 4,805,023	\$ -	\$ 257,182	\$ (257,182)	\$ 4,805,023
Accounts receivable (Note 3)	5,314,725	-	-	-	5,314,725
Due from affiliate	1,362,106	-	-	(1,362,106)	-
Assets limited as to use (Note 4)	1,719,977	-	-	-	1,719,977
Other current assets	966,145	86,875	121,499	257,182	1,431,701
Total current assets	14,167,976	86,875	378,681	(1,362,106)	13,271,426
Property and Equipment - Net (Note 5)	17,640,655	2,552,009	-	-	20,192,664
Other Assets					
Bond issue costs	652,788	-	-	-	652,788
Other noncurrent assets	25,000	-	138,401	-	163,401
Total assets	<u><u>\$ 32,486,419</u></u>	<u><u>\$ 2,638,884</u></u>	<u><u>\$ 517,082</u></u>	<u><u>\$ (1,362,106)</u></u>	<u><u>\$ 34,280,279</u></u>
Liabilities and Net Assets					
Current Liabilities					
Current portion of long-term debt (Note 7)	\$ 516,693	\$ 26,969	\$ -	\$ -	\$ 543,662
Due to affiliate	-	1,362,106	-	(1,362,106)	-
Accounts payable	1,824,676	1,900	-	-	1,826,576
Estimated third-party payor settlements (Note 6)	742,350	-	-	-	742,350
Accrued liabilities and other	2,654,944	-	-	-	2,654,944
Total current liabilities	5,738,663	1,390,975	-	(1,362,106)	5,767,532
Long-term Debt - Net of current portion (Note 7)	11,523,750	377,571	-	-	11,901,321
Total liabilities	17,262,413	1,768,546	-	(1,362,106)	17,668,853
Net Assets					
Invested in capital assets - Net of related debt	5,600,212	2,147,469	-	-	7,747,681
Restricted for specific operating activities	7,837	-	-	-	7,837
Unrestricted (deficit)	9,615,957	(1,277,131)	517,082	-	8,855,908
Total net assets	15,224,006	870,338	517,082	-	16,611,426
Total liabilities and net assets	<u><u>\$ 32,486,419</u></u>	<u><u>\$ 2,638,884</u></u>	<u><u>\$ 517,082</u></u>	<u><u>\$ (1,362,106)</u></u>	<u><u>\$ 34,280,279</u></u>

Sturgis Hospital

Balance Sheet September 30, 2007

	Sturgis Hospital	Grobheiser	Sturgis Hospital Foundation	Eliminating Entries	Total
Assets					
Current Assets					
Cash and cash equivalents	\$ 4,143,269	\$ -	\$ 141,158	\$ (141,158)	\$ 4,143,269
Accounts receivable (Note 3)	5,547,261	-	-	-	5,547,261
Due from affiliate	1,245,610	-	-	(1,245,610)	-
Assets limited as to use (Note 4)	1,824,322	-	-	-	1,824,322
Other current assets	1,281,238	48,405	103,390	141,158	1,574,191
Total current assets	14,041,700	48,405	244,548	(1,245,610)	13,089,043
Property and Equipment (Note 5)	18,008,121	2,622,553	-	-	20,630,674
Other Assets					
Bond issue costs	677,151	-	-	-	677,151
Other noncurrent assets	25,000	-	178,951	-	203,951
Total assets	<u>\$ 32,751,972</u>	<u>\$ 2,670,958</u>	<u>\$ 423,499</u>	<u>\$ (1,245,610)</u>	<u>\$ 34,600,819</u>
Liabilities and Net Assets					
Current Liabilities					
Current portion of long-term debt (Note 7)	\$ 291,726	\$ 113,035	\$ -	\$ -	\$ 404,761
Due to affiliate	-	1,245,610	-	(1,245,610)	-
Accounts payable	1,541,704	1,300	3,942	-	1,546,946
Estimated third-party payor settlements (Note 6)	1,607,449	-	-	-	1,607,449
Accrued liabilities and other	2,342,607	-	-	-	2,342,607
Total current liabilities	5,783,486	1,359,945	3,942	(1,245,610)	5,901,763
Long-term Debt (Note 7)	11,285,096	404,540	-	-	11,689,636
Total liabilities	17,068,582	1,764,485	3,942	(1,245,610)	17,591,399
Net Assets					
Invested in capital assets - Net of related debt	6,431,299	2,104,978	-	-	8,536,277
Restricted for specific operating activities	7,347	-	-	-	7,347
Unrestricted (deficit)	9,244,744	(1,198,505)	419,557	-	8,465,796
Total net assets	15,683,390	906,473	419,557	-	17,009,420
Total liabilities and net assets	<u>\$ 32,751,972</u>	<u>\$ 2,670,958</u>	<u>\$ 423,499</u>	<u>\$ (1,245,610)</u>	<u>\$ 34,600,819</u>

Sturgis Hospital

Statement of Revenue, Expenses, and Changes in Net Assets Year Ended September 30, 2008

	Sturgis Hospital	Grobheiser	Sturgis Hospital Foundation	Eliminating Entries	Total
Operating Revenues					
Net patient service revenue	\$ 37,492,014	\$ -	\$ -	\$ -	\$ 37,492,014
Other	110,127	271,357	-	(60,687)	320,797
Total operating revenues	37,602,141	271,357	-	(60,687)	37,812,811
Operating Expenses					
Salaries and wages	15,499,778	-	-	-	15,499,778
Employee benefits and payroll taxes	5,378,461	-	-	-	5,378,461
Operating supplies and expenses	5,214,976	648	-	-	5,215,624
Purchased services	1,182,908	22,284	-	-	1,205,192
Insurance	744,085	4,083	-	-	748,168
Utilities	805,267	112,082	-	-	917,349
Other	2,318,948	-	-	(54,687)	2,264,261
Fees	5,345,952	6,000	-	(6,000)	5,345,952
Depreciation and amortization	1,406,969	134,356	-	-	1,541,325
Total operating expenses	37,897,344	279,453	-	(60,687)	38,116,110
Operating Loss	(295,203)	(8,096)	-	-	(303,299)
Other Income (Expenses)					
Interest income	142,765	-	-	-	142,765
Contributions	165,126	-	97,882	-	263,008
Other expenses	-	-	(357)	-	(357)
Other income	69,583	-	-	-	69,583
Interest expense	(541,655)	(28,039)	-	-	(569,694)
Total other income (expenses)	(164,181)	(28,039)	97,525	-	(94,695)
(Decrease) Increase in Net Assets	(459,384)	(36,135)	97,525	-	(397,994)
Net Assets - Beginning of year	15,683,390	906,473	419,557	-	17,009,420
Net Assets - End of year	\$ 15,224,006	\$ 870,338	\$ 517,082	\$ -	\$ 16,611,426

Sturgis Hospital

Statement of Revenue, Expenses, and Changes in Net Assets Year Ended September 30, 2007

	Sturgis Hospital	Grobheiser	Sturgis Hospital Foundation	Eliminating Entries	Total
Operating Revenues					
Net patient service revenue	\$ 37,236,828	\$ -	\$ -	\$ -	\$ 37,236,828
Other	126,253	299,230	-	(60,687)	364,796
Total operating revenues	37,363,081	299,230	-	(60,687)	37,601,624
Operating Expenses					
Salaries and wages	15,815,092	-	-	-	15,815,092
Employee benefits and payroll taxes	6,272,806	-	-	-	6,272,806
Operating supplies and expenses	5,581,786	1,662	-	-	5,583,448
Purchased services	1,089,549	21,013	-	-	1,110,562
Insurance	765,728	4,083	-	-	769,811
Utilities	811,050	110,544	-	-	921,594
Other	2,086,565	-	-	(54,687)	2,031,878
Fees	5,253,686	6,000	-	(6,000)	5,253,686
Depreciation and amortization	1,436,951	130,645	-	-	1,567,596
Total operating expenses	39,113,213	273,947	-	(60,687)	39,326,473
Operating Income (Loss)	(1,750,132)	25,283	-	-	(1,724,849)
Other Income (Expenses)					
Interest income	228,753	-	-	-	228,753
Loss on sale of property	(5,597)	-	-	-	(5,597)
Sale of bed licenses	1,740,000	-	-	-	1,740,000
Contributions	288,586	-	109,250	-	397,836
Other expenses	-	-	(221,862)	-	(221,862)
Other income	78,184	-	-	-	78,184
Interest expense	(555,708)	(36,645)	-	-	(592,353)
Total other income (expenses)	1,774,218	(36,645)	(112,612)	-	1,624,961
Increase (Decrease) in Net Assets	24,086	(11,362)	(112,612)	-	(99,888)
Net Assets - Beginning of year	15,659,304	917,835	532,169	-	17,109,308
Net Assets - End of year	<u>\$ 15,683,390</u>	<u>\$ 906,473</u>	<u>\$ 419,557</u>	<u>\$ -</u>	<u>\$ 17,009,420</u>

Sturgis Hospital

Statement of Cash Flows Year Ended September 30, 2008

	Sturgis Hospital	Grobheiser	Sturgis Hospital Foundation	Eliminating Entries	Total
Cash Flows from Operating Activities					
Cash received from patients and third-party payors	\$ 36,859,451	\$ -	\$ -	\$ -	\$ 36,859,451
Cash paid to suppliers and employees	(35,561,677)	(144,497)	(3,942)	(116,024)	(35,826,140)
Other receipts from operations	110,127	271,357	-	-	381,484
Cash received from other receivables	-	(38,470)	22,441	-	(16,029)
Net cash provided by operating activities	1,407,901	88,390	18,499	(116,024)	1,398,766
Cash Flows from Investing Activities					
Purchase of investments	(886,518)	-	-	-	(886,518)
Proceeds from sale or maturities of investments	990,863	-	-	-	990,863
Investment income	142,765	-	-	-	142,765
Advances to affiliates	(116,496)	-	-	-	(116,496)
Net cash provided by investing activities	130,614	-	-	-	130,614
Cash Flows from Capital and Related Financing Activities					
Purchase of capital assets	(1,033,436)	(63,812)	-	-	(1,097,248)
Issuance of long-term debt	757,541	-	-	-	757,541
Interest paid on long-term debt	(541,655)	(28,039)	-	-	(569,694)
Principal payments on long-term debt	(293,920)	(113,035)	-	-	(406,955)
Other	69,583	-	-	-	69,583
Advances from affiliates	-	116,496	-	-	116,496
Contributions received	165,126	-	97,525	-	262,651
Net cash (used in) capital and related financing activities	(876,761)	(88,390)	97,525	-	(867,626)
Increase in Cash and Cash Equivalents	661,754	-	116,024	(116,024)	661,754
Cash and Cash Equivalents - Beginning of year	4,143,269	-	141,158	(141,158)	4,143,269
Cash and Cash Equivalents - End of year	<u>\$ 4,805,023</u>	<u>\$ -</u>	<u>\$ 257,182</u>	<u>\$ (257,182)</u>	<u>\$ 4,805,023</u>

Sturgis Hospital

Statement of Cash Flows (Continued) Year Ended September 30, 2008

A reconciliation of operating loss to net cash from operating activities is as follows:

	Sturgis Hospital	Grobheiser	Sturgis Hospital Foundation	Eliminating Entries	Total
Cash Flows from Operating Activities					
Operating loss	\$ (295,203)	\$ (8,096)	\$ -	\$ -	\$ (303,299)
Adjustments to reconcile operating loss to net cash from operating activities:					
Depreciation and amortization	1,406,969	134,356	-	-	1,541,325
(Increase) decrease in assets:					
Patient accounts receivable	232,536	-	-	-	232,536
Other current assets	333,389	(38,470)	22,441	(116,024)	201,336
Increase (decrease) in liabilities:					
Accounts payable	282,972	600	(3,942)	-	279,630
Accrued expenses	312,337	-	-	-	312,337
Cost report settlements payable	(865,099)	-	-	-	(865,099)
Net cash provided by operating activities	<u>\$ 1,407,901</u>	<u>\$ 88,390</u>	<u>\$ 18,499</u>	<u>\$ (116,024)</u>	<u>\$ 1,398,766</u>

There was no significant noncash investing, capital, and financing activities for 2008.

Sturgis Hospital

Statement of Cash Flows Year Ended September 30, 2007

	Sturgis Hospital	Grobheiser	Sturgis Hospital Foundation	Eliminating Entries	Total
Cash Flows from Operating Activities					
Cash received from patients and third-party payors	\$ 38,819,447	\$ -	\$ -	\$ -	\$ 38,819,447
Cash paid to suppliers and employees	(38,741,527)	(143,201)	3,942	5,278	(38,875,508)
Other receipts from operations	126,253	299,230	-	-	425,483
Cash received from other receivables	-	(25,174)	103,392	-	78,218
Net cash provided by operating activities	204,173	130,855	107,334	5,278	447,640
Cash Flows from Investing Activities					
Purchase of investments	(1,035,120)	-	-	-	(1,035,120)
Proceeds from sale of maturities of investments	2,372,331	-	-	-	2,372,331
Investment income	228,753	-	-	-	228,753
Advances to affiliates	(49,145)	-	-	-	(49,145)
Net cash provided by investing activities	1,516,819	-	-	-	1,516,819
Cash Flows from Capital and Related Financing Activities					
Purchase of capital assets	(1,104,399)	-	-	-	(1,104,399)
Sale of beds	1,740,000	-	-	-	1,740,000
Interest paid on long-term debt	(555,708)	(36,645)	-	-	(592,353)
Principal payments on notes payable	(425,156)	(143,355)	-	-	(568,511)
Other	72,587	-	-	-	72,587
Advances from affiliates	-	49,145	-	-	49,145
Contributions received (given)	288,586	-	(112,612)	-	175,974
Net cash provided by (used in) financing activities	15,910	(130,855)	(112,612)	-	(227,557)
Increase (Decrease) in Cash and Cash Equivalents	1,736,902	-	(5,278)	5,278	1,736,902
Cash and Cash Equivalents - Beginning of year	2,406,367	-	146,436	(146,436)	2,406,367
Cash and Cash Equivalents - End of year	<u>\$ 4,143,269</u>	<u>\$ -</u>	<u>\$ 141,158</u>	<u>\$ (141,158)</u>	<u>\$ 4,143,269</u>

Sturgis Hospital

Statement of Cash Flows (Continued) Year Ended September 30, 2007

A reconciliation of operating (loss) income to net cash from operating activities is as follows:

	Sturgis Hospital	Grobheiser	Sturgis Hospital Foundation	Eliminating Entries	Total
Cash Flows from Operating Activities					
Operating (loss) income	\$ (1,750,132)	\$ 25,283	\$ -	\$ -	\$ (1,724,849)
Adjustments to reconcile operating (loss) income to net cash from operating activities:					
Depreciation and amortization	1,436,951	130,645	-	-	1,567,596
(Increase) decrease in assets:					
Patient accounts receivable	378,791	-	-	-	378,791
Other receivables	-	(25,173)	103,392	-	78,219
Other current assets	(179,959)	-	-	5,278	(174,681)
Increase (decrease) in liabilities:					
Accounts payable	(709,355)	100	3,942	-	(705,313)
Accrued expenses	(175,951)	-	-	-	(175,951)
Cost report settlements payable	1,203,828	-	-	-	1,203,828
Net cash provided by operating activities	<u>\$ 204,173</u>	<u>\$ 130,855</u>	<u>\$ 107,334</u>	<u>\$ 5,278</u>	<u>\$ 447,640</u>

There was no significant noncash investing, capital, and financing activities for 2007.

Note I - Nature of Business and Significant Accounting Policies

Reporting Entity

Sturgis Hospital (the "Hospital"), is a short-term, acute-care facility providing inpatient, outpatient, and home healthcare services to the Sturgis, Michigan area. The Hospital is a component unit of the City of Sturgis, Michigan (a municipal corporation).

Blended Component Units

Grobheiser - A nonstock, nonprofit Michigan corporation whose purpose is to hold rental properties. Grobheiser is included as a blended component unit.

Sturgis Hospital Foundation (the "Foundation") - A nonstock, nonprofit Michigan corporation whose purpose is to fund projects of the Hospital. The Foundation is included as a blended component unit.

The Hospital reports Grobheiser and Sturgis Hospital Foundation as major proprietary funds.

Basis of Presentation - The financial statements have been prepared in accordance with generally accepted accounting principles as prescribed by Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, issued in June 1999. The Hospital follows the "business-type" activities reporting requirements of GASB Statement No. 34, which provide a comprehensive look at the Hospital's financial activities. The Hospital has elected not to apply provisions of all pronouncements of the Financial Accounting Standards Board (FASB) issued after November 30, 1989.

Proprietary Fund Accounting - The financial statements have been prepared on the accrual basis of accounting, whereby revenue is recognized when earned and expenditures are recognized when the related liabilities are incurred and certain measurement and matching criteria are met.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents - Cash and cash equivalents include cash and investments in highly liquid investments purchased with an original maturity of three months or less, excluding those amounts included in assets limited as to use.

Note I - Nature of Business and Significant Accounting Policies (Continued)

Assets Limited as to Use - Assets limited as to use include assets designated by the board of trustees for future capital improvement, over which the board retains control, and may, at its discretion, subsequently use for other purposes. Amounts required to meet current liabilities of the Hospital have been reclassified in the balance sheet. Assets limited as to use also include assets restricted by donor. These assets are recorded at fair value, based on quoted market prices, or estimated fair value.

Property and Equipment - Property and equipment are stated at cost. Depreciation is computed using straight-line methods over the estimated useful lives of the assets. Maintenance and repairs are charged to expense as incurred.

Net Assets - Net assets of the Hospital are classified in three components. Net assets invested in capital assets - net of related debt consists of capital assets net of accumulated depreciation and are reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted expendable net assets are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Hospital. Unrestricted net assets are the remaining net assets that do not meet the definition of invested in capital assets - net of related debt or restricted net assets.

Operating Revenue and Expenses - The statement of revenue, expenses, and changes in net assets distinguishes between operating and nonoperating revenues and expenses. Operating revenue results from exchange transactions associated with providing healthcare services - the Hospital's principal activity. Nonoperating activity, including interest income, expenses, and donations, are reported as nonoperating. Operating expenses are all expenses incurred to provide healthcare services, other than financing costs.

Net Patient Service Revenue - The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactively calculated adjustments arising under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined (see Note 6).

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Management believes that it is in compliance with all applicable laws and regulations. Final determination of compliance of such laws and regulations is subject to future government review and interpretation. Violations may result in significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.

Compensated Absences - Compensated absences are charged to operations when they are earned. Unused benefits are recorded in accrued liabilities in the financial statements.

Note 2 - Deposits and Investments

Michigan Compiled Laws section 129.91 (Public Act 20 of 1943, as amended), authorizes governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The Hospital is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which mature not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds registered under the Federal Investment Company Act of 1940, and contain investments only as previously described.

The Hospital has designated three banks for the deposit of its funds.

The Hospital's cash and investments are subject to several types of risk, which are examined in more detail below:

Custodial Credit Risk of Bank Deposits - Custodial credit risk is the risk that in the event of a bank failure, the Hospital's deposits may not be returned to it. The Hospital does not have a deposit policy for custodial credit risk. The Hospital had \$5,316,575 and \$5,504,195 of bank deposits (certificates of deposit and checking and savings accounts) that were uninsured and uncollateralized at September 30, 2008 and 2007, respectively. The Hospital believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, the Hospital evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

Note 2 - Deposits and Investments (Continued)

Custodial Credit Risk of Investments - Custodial credit risk is the risk that, in the even of the failure of the counterparty, the Hospital will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Hospital does not have a policy for custodial credit risk.

At September 30, 2008, the following investment securities were held by a counterparty, not considered a financial institution:

Type of Investment	Carrying Value	How Held
Oakleaf Financial Services	\$ 282,232	Counterparty

At September 30, 2007, the following investment securities were held by a counterparty, not considered a financial institution:

Type of Investment	Carrying Value	How Held
Oakleaf Financial Services	\$ 449,138	Counterparty
Security Benefit	141,067	Counterparty

Interest Rate Risk - Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The Hospital's investment policy does not restrict investment maturities, other than commercial paper which can only be purchased with a 270-day maturity.

At September 30, 2008, the average maturities of investments are as follows:

Investment	Fair Value	Maturities
Commercial paper	\$ 299,214	10/21/2008
Commercial paper	296,115	1/16/2009
Commercial paper	276,420	4/17/2009
Commercial paper	205,479	3/6/2009
Municipal bonds	51,629	8/1/2011
Municipal bonds	21,125	10/1/2009

At September 30, 2007, the average maturities of investments are as follows:

Investment	Fair Value	Maturities
Commercial paper	\$ 217,355	11/16/2007
Municipal bonds	51,850	8/1/2011
Municipal bonds	25,125	10/1/2009

Sturgis Hospital

Notes to Financial Statements September 30, 2008 and 2007

Note 2 - Deposits and Investments (Continued)

Credit Risk - State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The Hospital's investment policy also states that any investments in obligations of the State of Michigan or any of its political subdivisions must be rated as investment grade by at least one rating service.

As of September 30, 2008, credit quality ratings of debt securities are as follows:

Investment	Fair Value	Rating	Rating Organization
Commercial paper	\$ 299,214	A-1 +	Standard & Poor's
Commercial paper	296,115	A-1 +	Standard & Poor's
Commercial paper	276,420	A-3	Standard & Poor's
Commercial paper	205,479	A-1 +	Standard & Poor's
Municipal bonds	51,629	AA	Standard & Poor's
Municipal bonds	21,125	AAA	Standard & Poor's

At September 30, 2007, credit quality ratings of debt securities are as follows:

Investment	Fair Value	Rating	Rating Organization
Commercial paper	\$ 217,355	A-1 +	Standard & Poor's
Municipal bonds	51,850	AA	Standard & Poor's
Municipal bonds	25,125	AAA	Standard & Poor's

Concentration of Credit Risk - The Hospital's investment policy states that not more than 50 percent of the cash and investments the Hospital holds can be investments in commercial paper at any one time. The Hospital is in compliance with this provision of the investment policy.

Sturgis Hospital

Notes to Financial Statements September 30, 2008 and 2007

Note 3 - Patient Accounts Receivable

The details of patient accounts receivable are as follows:

	2008	2007
Patient accounts receivable	\$ 12,497,725	\$ 11,321,261
Less:		
Allowance for uncollectible accounts	(1,307,000)	(1,405,000)
Allowance for contractual adjustments	(5,876,000)	(4,369,000)
Net patient accounts receivable	<u>\$ 5,314,725</u>	<u>\$ 5,547,261</u>

The Hospital grants credit without collateral to patients, most of whom are local residents and are insured under third-party payor agreements. The composition of receivables from patients and third-party payors was as follows:

	Percent	
	2008	2007
Medicare	34	27
Blue Cross/Blue Shield of Michigan	11	11
Medicaid	17	17
Commercial, HMO, and self-pay	38	45
Total	<u>100</u>	<u>100</u>

Note 4 - Assets Limited as to Use

Assets limited as to use consist of the following:

	2008	2007
Cash and cash equivalents	\$ 565,997	\$ 76,975
Investments	1,153,980	1,747,347
Total	<u>\$ 1,719,977</u>	<u>\$ 1,824,322</u>

Assets limited as to use are expected to be used for the following:

	2008	2007
Donor restricted for specific purpose	\$ 7,837	\$ 7,347
Restricted by board for future capital use	1,712,140	1,816,975
Total	<u>\$ 1,719,977</u>	<u>\$ 1,824,322</u>

Sturgis Hospital

Notes to Financial Statements September 30, 2008 and 2007

Note 5 - Capital Assets

Cost of capital assets and related depreciable lives for September 30, 2008 are summarized below:

	2007	Additions	Transfers	Retirements	2008	Depreciable Life - Years
Land and land improvements	\$ 495,850	\$ -	\$ -	\$ -	\$ 495,850	8-15
Building and improvements	19,356,018	7,067	(7,565)	-	19,355,520	15-40
Rental buildings and improvements	5,452,212	56,245	7,565	-	5,516,022	5-40
Furniture, fixtures, and equipment	17,159,269	165,419	-	-	17,324,688	5-20
Construction in progress	61,657	868,517	-	-	930,174	-
Total	42,525,006	\$ 1,097,248	\$ -	\$ -	43,622,254	
Less accumulated depreciation:						
Land and land improvements	245,452	\$ 9,875	\$ -	\$ -	255,327	
Building and improvements	5,048,479	656,543	-	-	5,705,022	
Rental buildings and improvements	2,829,657	134,354	-	-	2,964,011	
Furniture, fixtures, and equipment	13,770,744	734,486	-	-	14,505,230	
Total	21,894,332	\$ 1,535,258	\$ -	\$ -	23,429,590	
Net carrying amount	\$ 20,630,674				\$ 20,192,664	

Cost of capital assets and related depreciable lives for September 30, 2007 are summarized below:

	2006	Additions	Transfers	Retirements	2007	Depreciable Life - Years
Land and land improvements	\$ 492,850	\$ 3,000	\$ -	\$ -	\$ 495,850	8-15
Building and improvements	18,597,980	758,038	-	-	19,356,018	15-40
Rental buildings and improvements	5,452,212	-	-	-	5,452,212	5-40
Furniture, fixtures, and equipment	16,886,183	281,704	-	(8,618)	17,159,269	5-20
Construction in progress	-	61,657	-	-	61,657	-
Total	41,429,225	\$ 1,104,399	\$ -	\$ (8,618)	42,525,006	
Less accumulated depreciation:						
Land and land improvements	235,582	\$ 9,870	\$ -	\$ -	245,452	
Building and improvements	4,421,250	627,229	-	-	5,048,479	
Rental buildings and improvements	2,699,012	130,645	-	-	2,829,657	
Furniture, fixtures, and equipment	12,985,548	793,814	-	(8,618)	13,770,744	
Total	20,341,392	\$ 1,561,558	\$ -	\$ (8,618)	21,894,332	
Net carrying amount	\$ 21,087,833				\$ 20,630,674	

Note 5 - Capital Assets (Continued)

At September 30, 2008, the Hospital had remaining commitments related to the Commons Building construction project approximating \$1,000,000. This project is expected to be completed during the fiscal year ending September 30, 2009.

Note 6 - Cost Report Settlements

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. A summary of the basis of reimbursement with these third-party payors is as follows:

- **Medicare** - Inpatient, acute-care, and rehabilitation services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system based on clinical, diagnostic, and other factors. Outpatient and homecare services related to Medicare beneficiaries are reimbursed based on a prospectively determined amount per episode of care.
- **Medicaid** - Inpatient, acute-care services rendered to Medicaid program beneficiaries are also paid at prospectively determined rates per discharge. Capital costs relating to Medicaid patients are paid on a cost-reimbursement method. Outpatient and physician services are reimbursed on an established fee-for-service methodology.
- **Blue Cross/Blue Shield of Michigan** - Inpatient, acute-care services are reimbursed at prospectively determined rates per discharge. Outpatient services are reimbursed on a fee-for-service and percentage-of-charge basis.

The Hospital has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Contractual adjustments under third-party reimbursement programs represent the difference between actual charges for services and amounts reimbursed by third-party payors. Cost report settlements result from the adjustment of interim payments to final reimbursement under these programs that are subject to audit by fiscal intermediaries. Changes in estimated settlements resulted in an increase in net patient service revenues in 2008 of approximately \$1,570,000.

Sturgis Hospital

Notes to Financial Statements September 30, 2008 and 2007

Note 7 - Long-term Debt

Long-term liability activity for the year ended September 30, 2008 was as follows:

	2007	Current Year Additions	Current Year Reductions	2008	Amounts Due Within One Year
Bonds - 2004	\$ 9,740,000	\$ -	\$ (140,000)	\$ 9,600,000	\$ 150,000
Bonds - 2005	965,000	-	(20,000)	945,000	20,000
Sturgis Bank & Trust construction loan	-	757,541	-	757,541	19,902
Memorial Health Systems note	325,000	-	(52,000)	273,000	273,000
Century Bank & Trust building loan	184,436	-	(12,919)	171,517	13,603
Century Bank & Trust equipment loan	10,589	-	(1,678)	8,911	1,755
Century Bank & Trust R&F loan	273,266	-	(18,379)	254,887	19,166
City of Sturgis - Electric Fund	431,510	-	(26,969)	404,541	26,969
City of Sturgis - Electric Fund	65,648	-	(65,648)	-	-
City of Sturgis - Bonds	20,417	-	(20,417)	-	-
GE Financial healthcare loan (capital lease)	4,330	-	(4,330)	-	-
GE bone densitometer (capital lease)	43,867	-	(16,446)	27,421	17,102
Highland iCad SL 300 System (capital lease)	30,334	-	(28,169)	2,165	2,165
Total long-term debt	\$ 12,094,397	\$ 757,541	\$ (406,955)	\$ 12,444,983	\$ 543,662

Long-term liability activity for the year ended September 30, 2007 was as follows:

	2006	Current Year Additions	Current Year Reductions	2007	Amounts Due Within One Year
Bonds - 2004	\$ 10,000,000	\$ -	\$ (260,000)	\$ 9,740,000	\$ 140,000
Bonds - 2005	995,000	-	(30,000)	965,000	20,000
Memorial Health Systems note	377,000	-	(52,000)	325,000	52,000
Century Bank & Trust building loan	196,710	-	(12,274)	184,436	12,932
Century Bank & Trust equipment loan	12,193	-	(1,604)	10,589	1,669
Century Bank & Trust R&F loan	290,891	-	(17,625)	273,266	18,379
City of Sturgis - Electric Fund	458,479	-	(26,969)	431,510	26,969
City of Sturgis - Electric Fund	147,034	-	(81,386)	65,648	65,648
City of Sturgis - Bonds	55,417	-	(35,000)	20,417	20,417
GE Financial healthcare loan (capital lease)	14,181	-	(9,851)	4,330	4,330
GE bone densitometer (capital lease)	59,669	-	(15,802)	43,867	16,417
Highland iCad SL 300 System (capital lease)	56,334	-	(26,000)	30,334	26,000
Total long-term debt	\$ 12,662,908	\$ -	\$ (568,511)	\$ 12,094,397	\$ 404,761

The details of long-term debt are summarized as follows:

- Sturgis Building Authority Michigan Building Authority Bonds, Series 2004, payable annually from \$150,000 due on October 1, 2009 to \$725,000 due on October 1, 2034, plus interest paid semiannually with rates ranging from 3.75 percent to 4.75 percent, collateralized by Hospital assets
- Sturgis Building Authority Michigan Building Authority Bonds, Series 2005, payable annually from \$20,000 due on October 1, 2009 to \$605,000 due on October 1, 2034, plus interest paid semiannually with rates ranging from 4.25 percent to 4.8 percent, collateralized by Hospital assets

Note 7 - Long-term Debt (Continued)

- The Sturgis Bank & Trust construction note issued in the amount of \$2,300,000. As of September 30, 2008, the Hospital had drawn \$747,541 on this note. The remainder is expected to be drawn in fiscal year 2009. The note bears interest at 4.4 percent. Interest and principal payments are due monthly. As of February 25, 2009, the note will be converted to a five-year balloon with a 20-year amortization. The note is secured by a mortgage on the property, security agreement, and assignment of rents and leases.
- The Memorial Health System note bears interest at prime (7.25 percent as of September 30, 2008), payable in monthly installments of \$4,333, plus interest, collateralized by certain buildings, and is due in January 2009.
- The Century Bank & Trust building loan bears interest at 5.15 percent, payable in monthly installments of \$1,843, including interest, collateralized by certain buildings and is due in full in August 2018.
- The Century Bank & Trust equipment loans bears interest at 4.5 percent, payable in monthly installments of \$177, including interest, collateralized by certain equipment, and is due in full in June 2019.
- The Century Bank & Trust R&F loan bears interest at 4.2 percent, payable in monthly installments of \$2,459, including interest, collateralized by certain equipment, and is due in full in June 2019.
- The City of Sturgis - Electrical Fund note is payable in monthly installments of \$2,247, plus interest at 6 percent, collateralized by improvements to rental office building, and is due in full in September 2023.
- The City of Sturgis - Electrical Fund note is payable in monthly installments of \$7,333, including interest at 6 percent, collateralized by improvement to the rental office building, and is due in full in June 2008.
- The City of Sturgis - Bonds, a loan from the City of Sturgis for repayment of bonds, are payable in monthly installments of \$6,402, including interest at 4.96 percent, collateralized by Hospital revenue, and is due in full in April 2008.
- The GE Financial Healthcare loan is a capital lease obligation with monthly payments of \$883, including imputed interest of 7.62 percent, collateralized by equipment.
- The GE Financial Services loan is a capital lease obligation with monthly payments of \$1,492, including imputed interest of 4 percent, collateralized by equipment.
- The Highland Capital Corporation loan is a capital lease obligation with monthly payments of \$2,167, collateralized by equipment.

Sturgis Hospital

Notes to Financial Statements September 30, 2008 and 2007

Note 7 - Long-term Debt (Continued)

The following is a schedule by years of principal and interest as of September 30, 2008:

Years Ending September 30	Long-term Debt		Capital Lease Obligation	
	Principal	Interest	Principal	Interest
2009	\$ 524,398	\$ 569,827	\$ 19,264	\$ 802
2010	268,354	557,363	10,322	143
2011	281,183	537,238	-	-
2012	294,143	531,859	-	-
2013	316,529	489,835	-	-
2014-2018	2,299,196	2,230,199	-	-
2019-2023	1,931,594	1,812,581	-	-
2024-2028	2,425,000	1,323,866	-	-
2029-2033	3,290,000	675,149	-	-
2034-2035	785,000	37,318	-	-
Total	<u>\$12,415,397</u>	<u>\$ 8,765,235</u>	<u>\$ 29,586</u>	<u>\$ 945</u>

Note 8 - Retirement Benefits

Plan Description - The Hospital participates in the City of Sturgis Employees' Retirement System (the "System"), which is a defined benefit pension plan that covers all employees of the City of Sturgis, Michigan, including the Hospital, who normally work 1,000 hours or more a year. The System provides retirement, disability, and death benefits to plan members and their beneficiaries. At December 31, 2006, the date of the most recent actuarial valuation, Hospital membership consisted of 107 retirees and beneficiaries currently receiving benefits and 314 current active employees. The plan does not issue a separate financial report.

Contributions - Plan member contributions are recognized in the period in which the contributions are due. Employer contributions to the plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan. The funding policy provides for periodic employer contributions at actuarially determined rates. Administrative costs of the plan are financed through investment earnings. Employees of the Hospital are required to contribute 3 percent to the plan.

Note 8 - Retirement Benefits (Continued)

Annual Pension Cost - For the year ended September 30, 2008, the Hospital's annual pension cost for the plan was equal to the Hospital's required and actual contribution. The Hospital's annual pension costs were \$918,943, \$1,340,837, and \$1,301,067 in 2008, 2007, and 2006, respectively. The annual required contribution was determined as part of an actuarial valuation at December 31, 2005, using the entry actual age cost method. Significant actuarial assumptions used by the plan include (a) a 7 percent investment rate of return, (b) projected salary increase of 5.0 percent to 17.5 percent per year, and (c) no cost of living adjustments. Both (a) and (b) included an inflation component of 4.5 percent. The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility over a five-year period. The unfunded actuarial liability is being amortized as a level percentage of payroll. The remaining amortization period is 19 years. The assets as of the valuation date were less than the accrued liabilities for all divisions. Due to the underfunding of the plan, it is anticipated that the contribution requirement will be increased in future years.

The following table sets forth the funded status and amounts for the City of Sturgis Employees' Retirement System:

	Years Ended December 31		
	2006	2005	2004
Actuarial value of assets	\$ 50,053,659	\$ 47,369,804	\$ 45,968,634
Actuarial accrued liability	\$ 53,867,915	\$ 50,314,340	\$ 47,243,463
Underfunded AAL	\$ (3,814,256)	\$ (2,944,536)	\$ (1,274,829)
Funded ratio (percentage)	93 %	94 %	97 %
Covered payroll	\$ 19,202,376	\$ 18,671,016	\$ 19,515,461
UAAL as a percentage of covered payroll	20 %	16 %	7 %

The Hospital represents approximately 57 percent of the City of Sturgis Employees' Retirement System plans assets.

Note 9 - Risk Management

The Hospital is exposed to various risks of loss related to property loss, torts, errors, omissions, and employee injuries (workers' compensation), as well as medical benefits provided to employees. The Hospital has purchased commercial insurance for malpractice and general liability claims and participates with the City of Sturgis, Michigan for claims relating to workers' compensation; the Hospital is self-insured for medical benefits claims. Settled claims relating to commercial insurance have not exceeded the amount of insurance in any of the past three years.

Note 9 - Risk Management (Continued)

Self-insured Health Benefits - The Hospital estimates the liability for medical claims that have been incurred through the end of the fiscal year, including both claims that have been reported, as well as those that have not been reported. These estimates are recorded as a short-term liability.

	2008	2007
Estimated liability - Beginning of year	\$ 400,000	\$ 400,000
Estimated claims incurred, including changes in estimates	3,096,695	3,095,883
Claim payments	<u>(3,146,695)</u>	<u>(3,095,883)</u>
Estimated liability - End of year (Note 11)	<u>\$ 350,000</u>	<u>\$ 400,000</u>

Malpractice - The Hospital is insured against medical malpractice claims under a claims-made policy, whereby only the claims reported to the insurance carrier during the policy period are covered regardless of when the incident giving rise to the claim occurred. Under the terms of the policy, the Hospital must pay a deductible toward the cost of litigating or settling any asserted claims. In addition, the Hospital bears the risk of the ultimate costs of any individual claim exceeding the policy limits for claims asserted in the policy year.

Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during the claims-made term, but reported subsequently, will be uninsured.

The Hospital has been named a defendant in several malpractice suits. At this time, it is premature to evaluate the likely outcomes, amounts of settlements, if any, or whether they could exceed the insurance coverage. Management intends to vigorously defend these suits and does not expect any unfavorable impacts. Accordingly, an accrual has been made in Note 11 of these financial statement for the deductible potentially payable by the Hospital on the malpractice suits for the years ended September 30, 2008 and 2007.

Sturgis Hospital

Notes to Financial Statements September 30, 2008 and 2007

Note 10 - Charity Care

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. The following information measures the level of charity care provided:

	2008	2007
Charges forgone, based on established rates	\$ 794,084	\$ 719,069

In addition, under arrangements with various governmental insurance programs, the Hospital provides significant care to the local indigent population for which reimbursement for services rendered is generally less than the cost of providing such services. As part of its obligation to the local communities, the Hospital also provides numerous other services that benefit the communities and are generally performed at no charge.

Note 11 - Accrued Liabilities

The details of accrued liabilities at September 30, 2008 and 2007 are as follows:

	2008	2007
Payroll and related items	\$ 938,584	\$ 818,487
Compensated absences	1,042,187	1,057,047
Professional liability claims (Note 9)	291,427	49,758
Self-insurance health benefit liability (Note 9)	350,000	400,000
Other	32,746	17,315
Total accrued liabilities	<u>\$ 2,654,944</u>	<u>\$ 2,342,607</u>

Note 12 - Postemployment Healthcare Benefits

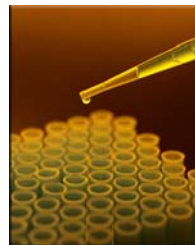
In addition to providing pension benefits, the Hospital provides healthcare benefits for retirees. Currently, 69 retirees meet those eligibility requirements. The Hospital is self-insured for retirees' medical benefit claims. The Hospital's net cost for providing retirees' healthcare benefits was \$596,853 (after retirees' contributions of \$91,868) for the year ended September 30, 2007.

The Hospital terminated the postemployment healthcare benefits offered effective January 1, 2008.

Note 13 - Union Contracts

Approximately 57 percent of the Hospital's employees are subject to individual agreements. All of these agreements expire in September 2009, except for the agreement with house supervisors, which expires in December 2009.

Sturgis Hospital
Report to the Finance Committee
September 30, 2008



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Management Letter Comments

To the Finance Committee
Sturgis Hospital

In planning and performing our audit of the financial statements of Sturgis Hospital (the "Hospital") as of and for the year ended September 30, 2008, in accordance with auditing standards generally accepted in the United States of America, we considered the Hospital's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control. Accordingly, we do not express an opinion on the effectiveness of the Hospital's internal control. Due to recently enacted audit standards, our consideration and assessment of internal controls was significantly more in-depth than in prior years.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

All of the items are presented for your consideration as outlined below:

Title	Exhibit
Manual Journal Entries - Significant Deficiency	A
IT General Controls - Control Deficiencies	B
Medicare Advantage Plans	C

This communication is intended solely for the information and use of management, the board of directors, the finance committee, and others within the Hospital and is not intended to be, and should not be, used by anyone other than these specified parties.

Thank you for the opportunity to be of service to the Hospital. Should you wish to discuss any of the items included in this report, we would be happy to do so.

December 17, 2008

Plante & Moran, PLLC

Exhibit A

Manual Journal Entries - Significant Deficiency

During our audit procedures, we noted a significant amount of manual journal entries being made on a monthly basis. Ideally, the number of manual journal entries should be minimal, but in cases where manual journal entries are necessary it is important those entries are reviewed by someone independent from the process. It appears the manual entries prepared by the controller are not reviewed at this time. We recommend the CFO review all manual entries made by the controller on a periodic basis to ensure all entries are correct and appropriate.

Exhibit B

IT General Controls - Control Deficiencies

Access Termination/Access Review

When access is removed for employees, last login date and time are not confirmed. We recommend logging this information and retaining it to ensure access is being monitored.

Authentication Controls - Network and Application

Network - Password length is set to six characters and complexity is not enforced. The number of unsuccessful login attempts is set at four.

Application - Password length is set at three characters and complexity is not enforced.

We recommend password settings be strengthened by requiring lengths of seven or more characters and complexity should be enforced. We also recommend unsuccessful attempts should be set to three or less.

Backup Procedures

Backup tapes are not rotated to an offsite location at least five miles away. It is suggested that backup tapes be rotated to an offsite location at least five miles away to protect them from disaster at the primary location.

Environmental Controls

Servers are not protected from water damage. It is recommended that suppression devices be put in place as well as the servers being elevated at least three feet above floor level to maintain normal and efficient processing of servers and network devices.

Exhibit C

Medicare Advantage Plans

Over the past years, Sturgis Hospital has seen a significant shift from beneficiaries covered under traditional Medicare to Medicare Advantage plans. Medicare Advantage plans are paid by Medicare based on a monthly premium and then the plans are responsible for the health care received by the beneficiary. This shift from regular Medicare to Medicare Advantage plans can result in additional burdens and cost for providers due to having to bill multiple insurance companies for Medicare services.

We would also encourage the Hospital to evaluate the required contractual allowance for Medicare Advantage plans using paid claims data of the Medicare Advantage plans, as they may be different than the traditional Medicare plan.

Engagement Scope

Our audit plan represented an approach responsive to the assessment of risk for Sturgis Hospital. Specifically, we designed our audit to:

- Express an opinion on the September 30, 2008 financial statements of the Hospital
- Issue the required communications under SAS 114 to assist the finance committee in overseeing management's financial reporting and disclosure process

Required Communications Under SAS 114

Statement on Auditing Standards No. 114 (as amended) and other professional standards require the auditor to communicate certain matters to the board that may assist the finance committee in overseeing management's financial reporting and disclosure process. Below, we summarize these required communications as they apply to the Hospital.

Area	Comments
<p>Auditors' Responsibilities Under Generally Accepted Auditing Standards (GAAS)</p> <p>Management has the responsibility for adopting sound accounting policies, for maintaining an adequate and effective system of accounts, for the safeguarding of assets, and for devising an internal control structure that will, among other things, help ensure the proper recording of transactions. The transactions that should be reflected in the accounts and in the financial statements are matters within the direct knowledge and control of management. Our knowledge of such transactions is limited to that acquired through our audit. Accordingly, the fairness of representations made through the financial statements is an implicit and integral part of management's responsibility. We may make suggestions as to the form or content of the financial statements or even draft them, in whole or in part, based on management's accounts and records. However, our responsibility for the financial statements is confined to the expression of an opinion on them.</p> <p>The financial statements are the responsibility of management. Our audit was designed in accordance with auditing standards generally accepted in the United States of America to provide reasonable, rather than absolute, assurance that the financial statements are free of material misstatement. As a part of our audit, we obtained an understanding of internal control sufficient to plan our audit and to determine the nature, timing, and extent of testing performed. However, we were not engaged to and we did not perform an audit of internal control over financial reporting.</p> <p>HIPAA and corporate compliance testing are beyond the scope of a financial statement audit.</p>	<p>We have issued an unqualified opinion on the financial statements of the Hospital for the year ended September 30, 2008.</p>
<p>Materiality</p> <p>The concept of materiality is inherent in the work of an independent auditor.</p>	<p>An auditor places greater emphasis on those items that have, on a relative basis, more importance to the financial statements and greater possibilities of material error than with those items of lesser importance or those in which the possibility of material error is remote.</p>
<p>Critical Accounting Policies and Practices</p> <p>Auditing standards call for us to inform you regarding the initial selection of, and change in, significant accounting policies or their application. In addition, we are expected to inform you about the methods used to account for significant unusual transactions and the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.</p>	<p>For the year ended September 30, 2008, there were no significant changes in accounting policies or their applications.</p>

Area	Comments
<p>Hospital's Accounting Principles</p> <p>We describe our judgments about the quality and acceptability of the accounting policies as applied in the Hospital's financial reporting, including the consistency of the accounting policies and their application related to the financial statements and disclosures.</p>	<p>Management followed a consistent methodology with the prior year related to the establishment and maintenance of accounting policies and the related application of such policies in the preparation of financial statements.</p> <p>We believe that the underlying methodology used by the Hospital is reasonable.</p>
<p>Accounting Estimates</p> <p>Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Auditing standards call for us to report to you about accounting estimates that are particularly sensitive because of their significance to the financial statements or because of the possibility that future events affecting them may differ markedly from management's current judgments. Further, we are expected to report to you about the process used by management in formulating particularly sensitive accounting estimates and about the basis for our conclusions regarding the reasonableness of those estimates.</p>	<p>We have provided additional information in the section titled "Areas of Audit Emphasis." The areas of particular significance include:</p> <ul style="list-style-type: none"> • Net realizable value of patient revenue and accounts receivable (contractual and bad debt allowances) • Third-party payor settlements • Professional liability claims • Self-insured health benefits (IBNR) • Pension benefits
<p>The Adoption of, or a Change in, an Accounting Principle</p> <p>We communicate to the board the initial selection of, and any changes in, significant accounting principles or their application when the accounting principle or its application, including alternative methods of applying the accounting principle, has a material effect on the financial statements.</p>	<p>None</p>
<p>Significant or Unusual Transactions and Controversial or Emerging Areas</p> <p>We communicate to the board the methods used to account for significant unusual transactions and the effects of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.</p>	<p>None</p>
<p>Significant Audit Adjustments</p> <p>Auditing standards call for us to report to you significant audit adjustments that, in our judgment, may not have been detected except through the auditing procedures we performed.</p> <p>We communicate to the board the information about adjustments arising from the audit (whether recorded or not) that could, in our judgment, either individually or in the aggregate, have a significant effect on the Hospital's financial statements.</p>	<p>After the majority of all audit work was complete, management concluded to reduce contractual reserves by posting a journal entry totaling \$166,941. We have concluded contractual reserves are adequate after this entry was posted.</p>
<p>Uncorrected Possible Financial Statement Adjustments Considered by Management to be Immaterial</p> <p>Auditing standards also require us to inform the board about uncorrected possible financial statement adjustments identified by us during the current engagement and pertaining to the latest period presented, which were determined by management to be immaterial, both individually and in the aggregate, to the financial statements taken as a whole.</p>	<p>Retainage on the construction project was not recorded at year end. This entry would increase current liabilities and long-term assets by \$51,230.</p> <p>Charges were posted to the incorrect period. The net effect of this entry would be to increase net patient service revenue and accounts receivable by \$39,089.</p>

Area	Comments
Fraud and Illegal Acts We report to the board fraud and illegal acts involving senior management and fraud and illegal acts (whether caused by senior management or other employees) that cause a material misstatement of the financial statements.	We are not aware of any matters that require communication.
Material Weaknesses in Internal Control We are required to communicate all material weaknesses in internal control which may have been identified during the course of our audit.	In connection with our audit of Sturgis Hospital, we reviewed internal controls for the purposes of obtaining a sufficient understanding of internal control to plan the audit and to determine the nature, timing, and extent of tests to be performed, during which we did not identify any material weaknesses. We were not engaged to, and we did not, perform audits of internal control over financial reporting.
Other Information in Documents Containing Audited Financial Statements	None
Disagreements with Management on Financial Reporting Matters	None
Serious Difficulties Encountered in Dealing with Management when Performing the Audit	None
Major Issues Discussed with Management in Connection with Initial Retention	None
Consultation with Other Accountants	We are not aware of any consultations with other accountants.
Other Material Written Communications with Management	Material written communications include various documents, including these communications. Some of the other significant written communications include the following: <ul style="list-style-type: none"> • Engagement letter between the Hospital and Plante & Moran, PLLC • Management representation letter

Areas of Audit Emphasis

Key areas of audit emphasis and our judgments about the quality, not just the acceptability, of the Hospital's accounting principles as applied in its financial reporting are summarized in the table below.

Area	Accounting Policy	Judgments and Sensitive Estimates	Comments on Quality of Accounting Policy and/or Application
Net Realizable Value of Patient Accounts Receivable	The Hospital maintains accounting policies and procedures specifically related to these accounts adjusting amounts to reflect estimated amounts recoverable from patients and third-party payors based on paid claims experience.	Required allowances, reflecting the difference between standard rates and reimbursement, are based on aging and historical payment experience while considering current trends. Balance sheet valuation allowances are established for potential payment disallowances.	Management followed a consistent methodology with the prior year related to the establishment of allowances for doubtful accounts. Management reduced contractual reserves by approximately \$1.6 million in the current year. We believe the underlying methodology used by the Hospital is reasonable.
Estimated Settlements with Third-party Payors	The Hospital establishes current year estimates of cost reports to be filed based on current year data and prior year cost report relationships. Estimates of prior year settlements are updated as additional information (including filed cost reports and interim settlements) becomes available.	These accounts represent amounts due to Medicare and other payors for the settlement of outstanding cost reports and amounts due to other payors for contract issues. Laws and regulations are complex and these estimates may change by a material amount in the near term. Changes to these amounts will be reflected in the statement of operations in the year of the change.	We believe the underlying methodology used by the Hospital is reasonable.
Professional Liability Claims	The Hospital establishes an estimate of the ultimate expense based on conclusions reached by the in-house risk manager, legal counsel, and ongoing discussions related to incidents and reported claims with the Hospital's insurance carrier.	Estimates recorded by the Hospital are dependent upon underlying methods and analysis used by the insurance carrier and the accuracy of the underlying data.	Management has accrued its best estimate of these potential losses to the extent they fall within the limits of the insurance program or exceed the limits of insurance coverage. The loss reserve also includes estimates for claims and related legal expenses from unreported incidents arising from services provided to patients. We believe the underlying assumptions used by management and the resultant amounts are reasonable.
Self-insured Employee Health Benefit	The Hospital establishes an estimate of the ultimate expense based on conclusions reached by human resources and accounting, and ongoing discussions related to incidents and reported claims to the Hospital.	This estimate is based on actual claims and claims history.	Our conclusions regarding the reasonableness of these estimates are based on reviewing this information and trends and on testing management's computations. We believe the underlying methodology used by the Hospital is reasonable.

Area	Accounting Policy	Judgments and Sensitive Estimates	Comments on Quality of Accounting Policy and/or Application
Pension Benefits	<p>An actuary is used to estimate the net pension asset/liability and the related income/expense.</p> <p>The Hospital participates in the City of Sturgis Employees' Retirement System, which is a defined benefit plan under which liabilities are estimated for future employee benefits based on information from the plan's actuary.</p>	<p>Estimates are dependent upon underlying assumptions used by the actuary and the accuracy of the underlying data.</p>	<p>We believe the underlying assumptions used by the actuary are reasonable. The discount rate was determined using rates of return for high quality long-term bonds currently available and expected to be available during the period to maturity of the pension benefits.</p>

In addition, other areas of audit emphasis included:

- Cash and investments
- Accounts payable and purchasing cycle
- Fixed asset accounting and the applicable depreciation
- Debt and related testing of compliance with covenants
- Employee-related accrued liabilities and payroll cycle

Healthcare Landscape

In planning and performing our audit of the financial statements of the Hospital for the year ended September 30, 2008, we considered the overall accounting practices of the Hospital as well as the risks the Hospital is facing. The purpose of this section is to address some of these risks.

Reimbursement Update

Congress Introduces Administration's Medicare Trigger Bill

As required by the 2003 Medicare Modernization Act, House and Senate leaders introduced legislation proposed by the administration to respond to a Medicare funding warning issued by the program's directors last April. According to the administration, the legislation (H.R. 5480/S. 2662) takes an approach to strengthening Medicare that includes limits on means testing for Part D premiums and medical liability costs, improved health information technology and electronic medical records, transparency in price and quality information, and incentives for providers to deliver and Medicare beneficiaries to choose high-quality, low-cost health care. At the same time, the president's fiscal year 2009 budget proposes more than \$182 billion in cuts to the Medicare program over five years, \$137 billion of which would come from hospitals.

Medicare Recovery Audit Contractors Coming to Michigan

CMS recently completed a three-year demonstration project in Florida, California, and New York which utilized outside contractors (Medicare Recovery Auditors) to review payments to Medicare providers. During this demonstration project, the Medicare Recovery Audits (RAC) identified \$371 million of incorrect payments, with 96 percent of these payments being overpayment to providers and 4 percent being underpayments. The majority of the overpayments (85 percent) identified were from inpatient hospitals. It should be noted that many of these overpayments identified by the RACs are being appealed by the providers.

Based on the success of this program as determined by CMS, the demonstration project is being made permanent and expanded and phased in across the entire nation with Michigan scheduled to be included in 2009. The permanent program included various changes from the demonstration project including, but not limited to, the following:

- RACs will not be allowed to review any claims prior to October 1, 2007 under the permanent program.
- RACs will only be allowed to look back three years (vs. four years under the demonstration project).
- RACs will now be allowed to review current year claims.
- The permanent program will set limits on medical record requests.
- RACs will have to reimburse the contingency fees received if they lose at any level of appeal. Under the demonstration project, RACs only had to repay their fee if they lost at first level of appeal.
- RACs must use certified coders under the permanent program.

President Proposes Nearly \$200 Billion in Medicare and Medicaid Cuts

On February 4, 2008, President Bush proposed more than \$182 billion in cuts to the Medicare program over five years, \$64 billion of which would come from the hospital inpatient update. His fiscal year 2009 Department of Health and Human Services budget proposal would freeze Medicare updates for inpatient and outpatient services, inpatient rehab facilities, and long-term care hospitals from 2009-2011, with updates of market-basket minus 0.65 percent each year thereafter. Other Medicare reductions would include substantial cuts to indirect medical education and hospital capital and disproportionate share payments, an overall cut to hospitals through the establishment of a value-based purchasing program, and the elimination of payments for so-called “never events.” The Medicaid program would be cut by more than \$17 billion over five years.

Pay-for-performance

Quality of care improved in all five clinical areas measured as part of a recent pay-for-performance demonstration project conducted by CMS. In the project, the premier organization quality incentive, participating organizations were awarded \$8.85 million in bonus payments for showing measurable improvements in quality of care. The bonus payments were awarded based on relevant quality measures. It is clear that Medicare will continue moving forward on pay-for-performance initiatives.

Office of Inspector General News

Physician Recruitment

OIG provides safe harbors on physician recruitment for hospitals designated in a health professional shortage area (HPSA). Information on HPSA can be found at the following website: bphc.hrsa.gov.

OIG Reports on 2006 Achievements

For fiscal year (FY) 2006, the HHS Office of Inspector General (OIG) reported savings and expected recoveries of nearly \$38.2 billion for federal healthcare programs: \$35.8 billion in implemented recommendations and other actions to put funds to better use, \$789.4 million in audit receivables, and \$1.6 billion in investigative receivables. Also for FY 2006, OIG reported exclusions of 3,425 individuals and entities for fraud or abuse involving federal healthcare programs and/or their beneficiaries, 472 criminal actions against individuals or entities that engaged in crimes against departmental programs, and 272 civil actions, which include False Claims Act (FCA) and unjust enrichment suits filed in federal district court, civil monetary penalties law (CMPL) settlements, and administrative recoveries related to provider self-disclosure matters. Source: OIG Semiannual Report, December 5, 2006.

Highlights of OIG's 2008 Work Plan

The following items have been highlighted in OIG's 2008 work plan:

- Hospital capital payments
- Medicare-dependent hospital program testing
- Medicare disproportionate share payments
- Provider bad debts
- Compliance with Medicare transfer policy
- Inpatient wage index
- Inpatient payments for new technologies
- Medicare secondary payor
- Medical appropriateness and coding of DRGs
- Inappropriate payments for diagnostic x-ray in hospital emergency rooms
- Oversight of Joint Commission Hospital Accreditation process
- Place of services errors
- Medicare payments for selected physician services
- Appropriateness of Medicare payments for polysomnography
- Assignment rules by Medicare providers
- Geographic areas with high utilization of ultrasound services
- Physician reassignment of benefits

Tax Developments

Hospitals Can Share Health IT with Physicians

In an Internal Revenue Service (IRS) ruling issued in early May 2007, the IRS noted that sharing health information technology with physicians would not jeopardize a not-for-profit hospital's tax-exempt status. Under this ruling, the following requirements must be met:

- An electronic health record arrangement requires that the hospital and the physician comply with electronic health record regulations issued by the Department of Health and Human Services.
- The arrangement must grant to the hospital, as permitted by the law, access to all electronic medical records created by the physician.
- Participation must be open to all of the hospital's medical staff physicians.
- The hospital must provide the same level of subsidy to all of its medical staff physicians unless the level of the subsidy is related to the difference in the healthcare needs of the community and not based on differences in referrals.

IRS Initiative Targets Not-for-profit Compensation Practices

Under the new Tax-exempt Compensation Enforcement Project, the IRS will be requesting information from approximately 2,000 charities and foundations to review information and supporting documents on compensation practices and policies for specific executives. The IRS will also be reviewing insider transactions such as leasing arrangements to officers and others in the hospital.

Uncompensated Care Update

United States hospitals provided \$28.8 billion in uncompensated care in 2005, up from \$26.9 billion, or 7.1 percent from 2004. Since 2000, uncompensated care has increased 25 percent or \$5.3 billion. The survey, issued by American Hospital Association, is valued at cost of providing services for all bad debts and charity care and does not include amounts of Medicare and Medicaid reimbursement which are below the cost of providing services to Medicare and Medicaid participants. According to the survey, Medicare and Medicaid underpaid hospitals by \$15.5 billion and \$9.8 billion, respectively.

Accounting and Auditing Update

New Accounting Standards

Health Care Audit Guide - The AICPA Health Care task force is currently evaluating the Health Care Audit Guide as part of a comprehensive overhaul of the 1996 document. A draft of the guide is expected to be released for comments possibly later in 2008. Key areas to be addressed include: charity care reporting, accounting and reporting of derivatives, contributions, medical malpractice, accounting for transfers between unrelated corporations, and new basic financial statement presentations.